



OFFICE OF
THE DIRECTOR

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November 10, 1999

The Honorable Mike Huckabee, Governor
The Honorable Members of the Arkansas Legislature
The Citizens of Arkansas

It is my pleasure to transmit to you the Comprehensive Annual Financial Report of the State of Arkansas (the "State") for the fiscal year ended June 30, 1999. The report has been prepared by the Department of Finance and Administration. Responsibility for both the accuracy of data and the completeness and fairness of the presentation, including all disclosures, rests with the Department of Finance and Administration. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position of the various funds and account groups of the State. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities have been included.

The report is presented in three sections. The introductory section includes this transmittal letter with narrative commentary on matters of interest to the reader and the State's organizational chart; the financial section includes the Independent Auditors' Report, general purpose financial statements, notes to the financial statements, required supplementary information, combining financial statements by fund type, schedules for account groups and other schedules; the statistical section includes selected financial, economic and demographic data for the State on a multi-year basis.

All agencies, accounts, departments, boards and commissions that represent the State's reporting entity are included in this report. The criteria used in determining the State's reporting entity are fully discussed in Note 1. The State provides a full range of services including: education, health and human resources, transportation, public safety, conservation of natural resources, economic development and regulation of businesses and professionals.

ECONOMIC CONDITION AND OUTLOOK

The longest and most prosperous expansion in Arkansas history can be attributed to the State's competitive performance in worker productivity and new investment. The State's work force and other factors continue to attract investment in other sectors as well as manufacturing to the State. The fundamental determinant of wages is productivity; but wages are not the only determinant of the favorable rate of investment in Arkansas. Energy costs, investment in public infrastructure, geographical location, other labor compensation costs, housing costs, educational investment, environment, and State fiscal policy also contribute to the investment climate in Arkansas.

In fiscal 1999, non-agricultural payroll employment expanded by 16,500 jobs, a 1.5% increase over fiscal 1998. Since 1988, Arkansas employment has expanded by 278,700 jobs or at a compounded annual growth rate of 2.9%. The current record level of employment as of October 1999, of 1,199,700 jobs has been accompanied by a decline in the unemployment rate from 5.6% in 1998 to 4.2% in October 1999.

A longer term perspective shows that the unemployment rate fell from 7.8% in 1988, or from 85,900 people in fiscal 1998 to 52,700 in fiscal 1999. In addition, while State employment rose and unemployment fell, the State's population grew by 203,500 persons.

In fiscal 1999, real output of final goods and services, totaled \$56,043 million, an increase of 3.97% or \$2,142 million over fiscal 1998. Real output has grown at an annual compound rate of 3.7% since fiscal 1988.

The measure of real output per payroll employee is an important indicator of a broad-based improvement in the economic well being of the State's workers. Output per payroll employee has climbed from \$44,995 in fiscal 1988 to \$48,819 in fiscal 1999 as measured by constant 1992 dollars. This amount is 81.0% of the U.S. average up from 77.5% in fiscal 1991. Since fiscal 1988 the compound annual rate of growth of payroll worker productivity is 0.82%. This rate compares favorably to a U.S. growth rate of 0.85% per annum.

In fiscal 1998, average hourly earnings in manufacturing in Arkansas reached \$11.11 an hour, up from \$10.78 in fiscal 1997. Wages are now 82.4% of the national average of \$13.49, up from 79.2% in fiscal 1988.

Real investment in non-residential plant, buildings, and equipment rose from an annual amount of \$3.7 billion in fiscal 1988 to \$7.2 billion in fiscal 1999. This is an annual compound rate of growth of 6.8%.

Personal income consists of wages and salaries, dividends, interest, rent and transfer payments such as retirement incomes. Personal income does not include realized capital gains from the sale of assets. Personal income is measured in current dollars and reached a total of \$54,171 million in fiscal 1999 up by \$2,408 million or 4.7% over fiscal 1998. Since fiscal 1988, personal income has climbed from \$28,661 million at a compound annual growth rate of 6.3%.

Real disposable income has expanded every year from the fiscal 1988 level of \$30,128 million to the fiscal 1999 level of \$41,395 million at a compound annual growth rate of 3.23%.

Per capita income has grown from \$12,229 in fiscal 1988 to \$21,187 in fiscal 1999, for a compound annual growth rate of 5.45%. During this time, the State's population has increased from 2,343,700 to 2,557,000, an increase of 213,300 persons or an annual rate of growth of 0.84%. In addition, the State's share of U.S. per capita income rose from 74.1% in fiscal 1988 to 77.4% in fiscal 1999. The gap reflects differences in output per worker as well as differences in the cost of living and taxation levels.

Retail sales have risen from \$13.94 billion in fiscal 1988 to \$24.13 billion in fiscal 1999 for a compound annual growth rate of 5.6%.

MAJOR INITIATIVES

Highways and Transportation

The Governor established the need for an improved and well-maintained transportation infrastructure as vital to Arkansas' growth and prosperity. Working with the Legislature, the Governor signed Act 1028 of 1999 which provides for increases in diesel fuel and gasoline taxes over a period of years. The money will fund improvements to interstate highways and provide an accelerated completion schedule for the 1991 highway improvement program to improve other secondary roads. Act 1027 of 1999 allowed the Governor to call a special election to refer to the voters a bond issue to finance repair of the interstate highway system, which is ranked as one of the worst in the nation. The bonds will be repaid using future federal funds earmarked for interstates, the money from the diesel fuel tax increase in Act 1028, and state matching funds set aside to match federal turnback funds. Voters approved the bond issue in a statewide election held on June 15, 1999.

Tax Reform and Tax Relief

Actions of the 82nd General Assembly and the Governor resulted in significant accomplishments in tax reform and tax relief. Property tax refunds were increased, a Property Taxpayers' Bill of Rights was established, a law was passed requiring a county assessor to give notice to a property owner at least 45 days before a reappraisal, as well as a host of other property tax reform measures. Act 1185 of 1999 requires each county to institute a system of regular revaluation of all real estate. The revaluation efforts will be funded by the State. Counties have the option to conduct their own revaluation programs or contract the work to private firms. In either case, counties must adhere to new standards that ensure fairness and equity. Any assessment increases resulting from the revaluation efforts will be phased in over three years.

Several measures passed and signed by the Governor provided for income tax reform and relief, in particular to encourage saving and provide relief through changes in dependent tax credits and the state income tax credit for household and dependent care. Finally, Act 1005 of 1999 excludes the first 30% of a capital gain from the state individual income tax.

STAR System

STAR stands for **ST**reamline **A**uto **R**enewal. STAR is an easy way for Arkansas residents to renew motor vehicle registrations any time of the day or night from the comfort of their own home. Using the internet or a touch tone telephone, the system is available 7 days a week, 24 hours a day with the exception of the period of time between 11:50 PM to 12:10 AM.

All county assessors and collectors are provided with a method of reporting taxpayer's assessments and tax payments on-line in the STAR system. Insurance companies also report all vehicles insured to the State. This allows the State to create a shared database that includes assessment and tax collection information as well as vehicle insurance records.

An Arkansas taxpayer can enter a Revenue Office without taking proof of assessment, tax payment, and proof of liability insurance on their vehicle and process the auto renewal.

Education

The Governor proposed far reaching legislation in the area of Education that was passed during the 82nd General Assembly. Funding for the Smart Start Initiative was included in the budget for the Department of Education. Legislation was passed to allow for creation of charter schools by either converting existing schools or starting new ones. Repeal of unnecessary laws and changes in existing laws which will enhance the ability to administer effective programs in education were also passed. Legislation was also passed which provides for the first time, financial rewards for teachers who receive national certification.

Proposals passed during this session will have long lasting effects for higher education. Act 858 of 1999 raises the family income limit on the Academic Challenge Scholarship Program. This will allow more students to attend college and will encourage Arkansans to attend college in-state. Act 1158 of 1999 requires the Workforce Education and Career Opportunities Board to develop a performance-based accountability system for post-secondary and technical institutions. Act 652 of 1999 establishes the Arkansas Technical Careers Loan Forgiveness Program to assist students who will fill special needs areas in the technical skill fields.

Economic Development

In an increasingly competitive environment for economic development that includes nationwide competition for high paying jobs, Arkansas' economic development efforts have been retooled and refocused with remarkable results for the future of the State. Act 995 of 1999 amends the Manufacturers Investment Tax Credit Act of 1985 to expand eligibility to include businesses engaged in a variety of services. Income tax credits were passed for eligible businesses undertaking large capital investment or job-creation projects, and for companies purchasing or constructing a facility that designs, develops or produces electric vehicles or the fuel cells that power them. Another program, established by Act 448 of 1999, creates a two-year pilot program operated by the Department of Economic Development that makes participation loans in amounts from \$5,000 to \$80,000 to small business owners in the state.

Law Enforcement, Criminal Justice, and Juvenile Justice Reform

Government's most basic role is to keep our communities safe. The March 1998 shootings at Westside Middle School near Jonesboro and problems with the juvenile justice system prompted the Governor to propose legislation passed by the 82nd General Assembly. Act 1192 of 1999 authorizes juvenile judges to impose adult sanctions on offenders younger than 13 if convicted of capital or first-degree murder and judged competent to stand trial. It also allows 14 and 15 year olds convicted of a violent crime to receive adult sanctions. Significant funds were provided the Department of Human Services - Division of Youth Services to address adequate facility and equipment needs of supervising young offenders.

Act 565 of 1999 allows, at a prosecutor's request, state Crime Lab analysts to testify in court by two-way closed-circuit or satellite-transmitted television. Legislation was passed to address a plan for a statewide radio system. A group of representatives from various state agencies will make recommendations to the Governor and the Legislative Joint Committee on Advanced Communications and Information Technology by March 31, 2000. To add to the State's infrastructure for training law enforcement officers, Act 688 of 1999 authorizes construction of the Northwest Arkansas satellite training facility. Act 1213 of 1999 provides personnel and equipment for the Western Regional Drug Laboratory.

Family Issues

The Administration had clear recommendations in the areas of adoption reform and divorce reform for consideration by the 82nd General Assembly and had great success in passing several significant laws. Compliance with the federal Adoptions and Safe Families Act was accomplished with passage of Act 401 of 1999. Act 704 of 1999 allows judges to require divorcing parents of minors to complete two hours of parenting classes or require them to take part in divorce mediation.

Act 328 of 1999 extends subsidy payments from age 18 to 21 if a child has a documented disability that prevents him from living independently. Act 517 of 1999 amends the guardianship statute to comply with the Adoption and Safe Families Act. It allows any parent who is chronically ill or near death, without surrendering parental rights, to have a standby guardian appointed by the court. Finally, Act 518 of 1999 amends the adoption code to allow foster children to be adopted by their foster parents more quickly when they have been living in the home six months or longer.

Health and Human Services

Continuing the progress made in recent years, the Governor recommended passage of Act 849 of 1999, which changed the ARKids First Program from a pilot program to a permanent program. Originally passed in 1997, ARKids First provides preventive health care insurance to the children of those making up to 200% of the poverty level. There are more than 38,000 children already insured through the program. Act 1181 of 1999 established a Nursing Home Patients' Bill of Rights.

Government Efficiency and Anti-Corruption

Significant strides were made during the 82nd General Assembly toward improvements in government efficiency and anti-corruption legislation. The Governor signed into law several acts addressing these areas. Act 1061 of 1999 authorizes the Department of Finance and Administration to implement the Career Ladder Incentive Program for state employees. This legislation is complemented by passage of Act 222, which allows for a pilot project in performance-based budgeting. A major new project that also will pave the way for implementation of Performance Based Budgeting is authorization of a new statewide integrated information system.

Anti-corruption legislation was passed to protect public employees from retaliation by their employers when an employee has told the appropriate authority about a violation of the law or a waste of public money, property or manpower. Act 34 of 1999 prohibits constitutional officers, legislators and their spouses from receiving employment during and two years after their term in office. It prohibits job enhancement if the constitutional officer, legislator or spouse has a state job prior to the term in office. It also restricts constitutional officers, legislators and their spouses from entering into contracts and lease agreements or receiving grants unless the contract, lease or grant involves a competitive bid.

Military and Veterans Affairs

Act 270 of 1999 approves and provides an appropriation for construction of a State Veterans Cemetery on 75 acres donated by Camp Robinson. The State will loan \$500,000 to open the cemetery, and the federal government will repay those funds.

Electric Deregulation

Act 1556 of 1999 establishes the framework for a transition to competition in the electric industry. It will deregulate the sale of electricity generated between January 2002 and June 2003. It contains guidelines for how a utility's stranded costs are to be determined, requires that all reasonable cost mitigation measures be implemented, requires any utility's over-earnings to be used as an offset to stranded costs and allows the Public Service Commission discretion in every phase of the stranded-cost proceedings. The bill provides for a rate freeze for residential and small business customers for up to three years and continued rate regulation for customers who don't choose alternate energy suppliers.

FINANCIAL MANAGEMENT

The financial statements of the State are prepared in accordance with generally accepted accounting principles ("GAAP") which requires that specific fund types be used on the combined balance sheet.

There are four categories of funds. The first category is the governmental fund. The general fund is used to account for all general government activities not accounted for in another fund and is the only governmental fund currently in use.

The proprietary fund is used to account for activities similar to the private sector, where the determination of net income is necessary or useful for sound financial administration. A component of the proprietary fund is the enterprise fund which provides goods and services to outside parties.

The fiduciary fund is used to account for assets held on behalf of outside parties or other funds within the government. When assets are held under the terms of a formal trust agreement, a pension trust fund or expendable trust fund is used. The term “expendable” refers to the ability of the governing agent to spend the trust principal. Agency funds generally are used to account for assets that the government holds on behalf of others as their agent.

The higher education fund presents the State supported colleges and universities in accordance with the American Institute of Certified Public Accountants Industry Audit Guide, *Audits of Colleges and Universities*, and guidance as outlined by the National Association of College and University Business Officers and Governmental Accounting Standards Board.

Under GAAP, fund balance represents the excess of assets over liabilities. Therefore, it is possible for fund balance to remain unchanged while cash balances decrease or increase. In addition, certain amounts of fund balances may be reserved or “not spendable.”

Internal Controls

The management of the State is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and that adequate accounting data is compiled to allow the preparation of the financial statements in conformity with GAAP. The internal control structure has been designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, the reliability of financial records for preparing financial statements, and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Control

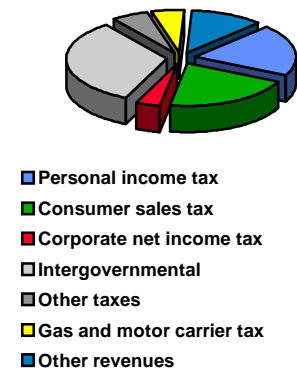
Budgetary control is maintained through legislative appropriation. Agencies submit budgetary requests to the Department of Finance and Administration. The Department of Finance and Administration compiles the executive budget on behalf of the Governor who submits it to the Legislature. The Department of Finance and Administration maintains control over the spending patterns of the State after the approval of the budget through control at the line item level. See Note 2 (Budgetary Basis Reporting – Budgetary Process) for further discussion of budgetary controls.

General Government Functions

Most State functions are financed through the general fund. The State's most significant sources of revenues in the general fund (GAAP basis) are taxes and intergovernmental. The State's most significant areas of expenditures from the general fund (GAAP basis) are the areas of public and higher education and health and human resources. The following charts present actual general fund (GAAP basis) revenues and expenditures for the fiscal year ended June 30, 1999 (expressed in thousands):

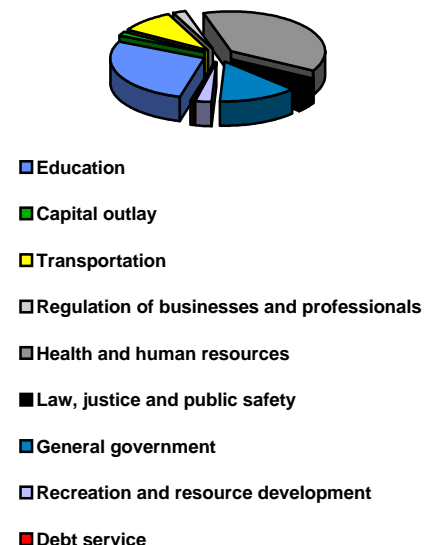
Revenues	1999	1998	Increase (Decrease) Percent
Personal income tax	\$ 1,625,316	\$ 1,553,778	4.60 %
Consumer sales tax	1,560,892	1,476,686	5.70 %
Corporate net income tax	248,664	268,605	(7.42)%
Gas and motor carrier tax	386,503	368,050	5.01 %
Other taxes	353,136	361,071	(2.20)%
Intergovernmental	2,459,368	2,387,385	3.02 %
Other revenues	<u>936,410</u>	<u>746,333</u>	<u>25.47 %</u>
Total	<u>\$ 7,570,289</u>	<u>\$ 7,161,908</u>	<u>5.70 %</u>

REVENUE BY SOURCE FOR GENERAL FUND - 1999



Expenditures	1999	1998	Increase (Decrease) Percent
Education	\$ 1,959,309	\$ 1,883,809	4.01 %
Health and human resources	2,614,967	2,496,628	4.74 %
Transportation	559,572	635,188	(11.90)%
Law, justice and public safety	311,176	265,313	17.29 %
Recreation and resource development	170,619	177,838	(4.06)%
General government	992,322	724,127	37.04 %
Regulation of businesses and professionals	139,345	121,450	14.73 %
Debt service	57,917	54,876	5.54 %
Capital outlay	<u>120,525</u>	<u>110,988</u>	<u>8.59 %</u>
Total	<u>\$ 6,925,752</u>	<u>\$ 6,470,217</u>	<u>7.00 %</u>

EXPENDITURES FROM GENERAL FUND - 1999



Governmental revenues increased modestly by 5.70%, reflecting additional personal income tax revenue and consumer sales tax revenue of \$71.5 million and \$84.2 million, respectively. Intergovernmental revenues increased by \$72 million due to increased fundings from the federal government for the Medicaid program. Consumer sales tax increased due to the strong economic growth of the State including an increase in personal income of approximately 4.8% over the prior year.

Expenditures increased in fiscal year 1999 by 7.00% as the demand for governmental services rose consistently with the increase in revenues. The principal reasons for the increase is due primarily to increases in health and human resources and general government expenditures.

Proprietary and Fiduciary Funds

The State's enterprise operations include the Workers' Compensation Commission, the Construction Assistance Revolving Loan Fund, and Other Revolving Loan Funds. Since it is the intent of these programs to primarily recover operating costs (including depreciation) through user charges, they utilize an accrual basis of accounting with a measurement focus on the flow of economic resources.

Fiduciary funds are used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governmental units or other funds. These include the expendable trust, pension trust and agency funds. Trust funds are established through trust agreements specifying how the funds will operate. Agency funds are custodial in nature and do not report fund balances. The trust funds include the Employment Security Division, Arkansas Judicial Retirement Plan, Arkansas Teacher Retirement Plan, Arkansas State Police Retirement Plan, Arkansas Highway Retirement Plan and Arkansas State Employees Retirement Plan. Agency funds include the State Insurance Department and Other Agencies.

Component Units

The component units include the accounts of Arkansas Student Loan Authority and Arkansas Development Finance Authority. These authorities are legally separate entities that are not operating departments of the State and are managed independently with their powers generally vested in a governing board. Each authority is established for a specific purpose, such as education and economic development.

Combined operating revenues and expenses for the State's authorities amounted to approximately \$99 million and \$124 million, respectively, for fiscal year 1999. The total combined amount of retained earnings at fiscal year end was \$134 million.

Debt Administration

The Constitution of the State of Arkansas does not limit the amount of general obligation bonds which may be issued by the State; however, no such bonds may be issued unless approved by the voters of the State at a general election or special election held for that purpose. The total outstanding general obligation bonded indebtedness, including special obligation and other debt instruments, of the governmental fund types of the State as of June 30, 1999, was approximately \$399 million. Arkansas currently has a rating of Aa3 from Moody's Investors Service and a rating of AA from Standard and Poors.

Cash Management

State funds are invested by the Treasurer and also by various state agencies, including the retirement systems and institutions of higher education. Permissible investments include those guaranteed by the United States of America, its agencies and instrumentalities (U.S. Government Obligations); repurchase agreements; corporate debt and equity obligations; and state and local government securities.

Risk Management

The State manages risk with a combination of self-insurance and commercial policies. The State established the Risk Management Office in accordance with State law for the purpose of analyzing and making recommendations as to cost effective loss control and safety programs for the various State agencies.

The State also established the State Employees Insurance Advisory Committee (the "Committee") by Act 48 of 1972 and allowed the Committee to pursue self-funding activities by Act 576 of 1975. The Committee provides comprehensive major medical care, prescription drug and life insurance for employees of the State and its participating component units, as well as their dependents, through the establishment of a variety of self-insured plans. The Committee also makes medical coverage available to retirees should they elect to continue such coverage at their own expense.

Year 2000

The State has adopted the provisions of Governmental Accounting Standards Board Technical Bulletin 99-1, *Disclosures about Year 2000 Issues - an amendment of Technical Bulletin 98-1*, which mandate certain Year 2000 disclosures either in the notes to the financial statements or in required supplementary information following the notes. The State has included such disclosures as required supplementary information following the notes to the general purpose financial statements. The State also established a website (<http://www.dis.state.ar.us/y2k/y2kintro.htm>) that discusses progress to date on the State of Arkansas Year 2000 Project.

Audit

The firm of Deloitte & Touche LLP performed the audit for the fiscal year ended June 30, 1999. Generally accepted auditing standards were used by the auditors in conducting the engagement. The auditors' report on the general purpose financial statements is included in the financial section of this report.

Awards

The Government Finance Officers Association of the United States and Canada ("GFOA") awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Arkansas for its Comprehensive Annual Financial Reports for the fiscal year ended June 30, 1998. This was the third consecutive year that the State has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report. The report must satisfy both generally accepted accounting principles and applicable legal requirements.

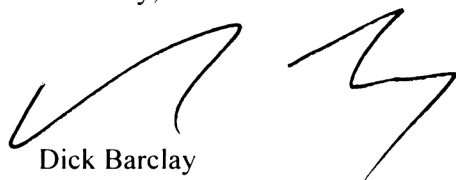
A Certificate of Achievement is valid for a period of one year only. We believe that our current report continues to conform to the Certificate of Achievement program requirements, and are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

Recognition for the leadership of accurate and timely financial reporting lies with Governor Mike Huckabee. He has made fiscal responsibility a high priority in his administration and his leadership has been crucial to the project's success. Governor Huckabee believes that this project will provide overall improvements in government accountability. It will save the State interest expense by providing market analysts, potential investors and others with complete, comparable financial information. It will provide the Legislature and others in key positions that require them to make financial decisions with clear, concise and complete financial data that is free of ambiguities or any misleading facts. The Governor's commitment to this project, especially his support of continued funding, demonstrates his firm belief in our continuing progress.

This report also would not be possible without the support of all state agencies that provided GAAP closing data on a timely basis. The future success of this project directly depends upon their continued cooperation and support as well.

Sincerely,



Dick Barclay
Director
Department of Finance and Administration

